DOCKET FILE COPY ORIGINAL

BEFORE THE

FEDERAL COMMUNICATIONS COMMISSION

WASHINGTON, D.C.

RECEIVED

MAY 12 1993

FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

In the Matter of	)	
	)	
Implementation of Sections 11 and 13 of the Cable Television Consumer Protection and Competition Act of 1992	))))	MM Docket No. 92-264
	)	
Horizontal and Vertical Ownership Limits, Cross-Ownership Limitations and Anti-trafficking Provisions	)))	

REPLY COMMENTS OF TELE-COMMUNICATIONS, INC.

WILLKIE FARR & GALLAGHER
Three Lafayette Centre
1155 21st Street, N.W.
Suite 600
Washington, D.C. 20036-3384

Its Attorneys

May 12, 1993

No. of Copies rec'd 0+5
List A B C D E

TABLE OF CONTENTS

SUMMARY

The comments filed in this proceeding, as well as the legislative history of the 1992 Cable Act and prior Commission decisions, reflect widespread recognition that vertical and horizontal ownership combinations in the cable industry have produced significant consumer benefits in the form of increased diversity and quality of programming. Thus, the Commission should avoid imposing highly restrictive limitations on such ownership combinations.

In addition, the Commission's recent Orders on program access, must carry, rate regulation and leased access, and the pre-existing public, educational, and governmental access rules, address the same fundamental behavioral and structural issues which underlie the ownership provisions of the 1992 Act. Since the Commission has already adopted extensive regulations intended to reduce whatever ability cable operators and programmers might

stringent and burdensome attribution schemes proposed by some parties in this proceeding appear to be based on a desire to handicap a competitive industry and, moreover, fail completely to balance the potential downside in terms of programming investment and consumer welfare that would result from their proposals. Also, the attribution rules adopted in the Program Access Order are inappropriate for purposes of the ownership rules because the issue in that proceeding was whether a cable operator could exercise "influence" over a programmer, whereas the issue in this proceeding is the ability of a cable operator to "control" access to subscribers or channels. TCI submits that concerns over "control" would only be triggered by a much higher attribution level than those adopted in the Program Access Order.

Finally, TCI responds to the Comments of several parties in this proceeding, including The Association of Independent Television Stations, Inc., The Motion Picture Association of America, The Consumer Federation of America, and David Waterman. Each of these commenters either states no basis, or, in the alternative, a seriously flawed basis, for their severely restrictive ownership proposals.

BEFORE THE

FEDERAL COMMUNICATIONS COMMISSION

WASHINGTON, D.C.

RECEIVED

MAY 12 1993

FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

In the Matter of Implementation of Sections 11 and 13 of the Cable Television Consumer Protection and Competition Act of 1992 Horizontal and Vertical Ownership Limits, Cross-Ownership Limitations and Anti-trafficking Provisions	)	MM Docket No. 92-264

REPLY COMMENTS OF TELE-COMMUNICATIONS, INC.

Tele-Communications Inc. ("TCI") hereby files its reply comments on the horizontal and vertical ownership and ownership attribution issues in the above-captioned proceeding.[1]

I. INTRODUCTION

The Comments filed in this proceeding reflect widespread recognition that vertical and horizontal ownership combinations in the cable industry have produced significant consumer

[1] Notice of Proposed Rulemaking and Notice of Inquiry in MM Docket No. 92-264, FCC 92-542 (rel. Dec. 28, 1992) ("Notice").

benefits.[2] Such combinations have increased program diversity and contributed significantly to the advancement of technology. The Commission should construe Section 11 so as to preserve those benefits in light of the current business and marketplace dynamics in which the cable industry operates. Those dynamics will be vitally affected by a series of recent Commission orders under the 1992 Cable Act that directly affect the ownership issues in this proceeding. The Commission itself has noted that the Program Access and Leased Access decisions address the same concerns that underlie the ownership provisions of the Act.[3] TCI believes the same is true of the Rate Regulation and Must Carry Orders.

Because those earlier decisions impose behavioral and structural regulations designed to address the competitive issues at the heart of this proceeding, it would be redundant -- if not counterproductive -- for the Commission to impose highly restrictive subscriber and channel occupancy limits in this proceeding. In each case, additional restrictions are likely to yield diminishing additional or marginal benefits in terms of achieving the objectives set by Congress, while still imposing their own additional costs. Setting regulations always involves

---

[2] Congress itself recognized these benefits. 1992 Cable Act, Sec. 11(f)(2)(D); <u>see also</u> H.R. Rep. No. 628, 102nd Cong., 2d Sess. 43 (1992) ("House Report").

[3] Implementation of Section 11 and 13 of the 1992 Cable Act, Horizontal and Vertical Ownership Limits, Cross-ownership Limitations and Anti-trafficking Provisions, MM Docket No. 92-264, FCC 92-233 (Rel. Feb. 26, 1993), at 2.

a balancing of benefits against costs. The fact that other Commission regulations are aimed at the same objectives makes it much more likely that restrictive ownership rules would impose additional costs that outweigh any additional benefits they yield.

Instead, the Commission should now carefully consider the entire fabric of its 1992 Cable Act rules. Where a perceived problem has been addressed in one or more rulemakings, it is unlikely to require cumulative treatment in yet another set of rules. This same concern for the overall fabric of the new rules governing cable television should lead the Commission to be careful that recurrent issues such as attribution of ownership interests are dealt with in a manner appropriate to the requirements of each particular regulatory issue.

TCI recognizes that the Commission must establish subscriber and channel occupancy limits. In its initial comments, TCI proposed a limit of approximately 30-40 percent of the proportion of national cable subscribers that could be served by a single entity and a rule permitting cable operators to devote a significant amount of system bandwidth to affiliated program services. These proposed limits are sufficiently high to enable cable operators to continue to obtain the efficiencies of vertical and horizontal ownership that have supported investment in programming and technology, yet are not so high that they constitute an evasion of the letter or spirit of Section 11 of the Act. Moreover, TCI's proposed limits have a rational basis.

Unlike some commenters in this proceeding who proposed limits based on nothing more than an apparent desire to handicap a traditional cable systems so that the public may benefit from the development of competitive distributors."[6] The regulations ensure that competitors to cable have the opportunity to obtain, on regulated terms, the same programming as cable operators. These rules are intended to increase competition to cable and reduce the supposed ability of cable operators to use horizontal concentration or vertical integration to obtain competitive advantages.

- **Leased Access** -- Similarly, the Commission noted that the leased access rules have as a central purpose "the promotion of competition in the delivery of diverse sources of video programming."[7] These rules enable programmers unaffiliated with the cable operator to obtain distribution on the operator's facilities in order to compete with the operator. Further, in some cases, cable operators must provide billing and collection services to the unaffiliated programmer, thus increasing the programmer's potential competitive strength. By increasing the competitive opportunities for unaffiliated programmers, the leased access rules reduce the need for stringent horizontal or vertical restrictions on cable operators. Similarly, the leased access rules are relevant to the vertical restraints in Section

---

[6] Implementation of Sections 12 and 19 of the 1992 Cable Act, Development of Competition and Diversity in Video Programming Distribution and Carriage, MM Docket No. 92-265, FCC 93-178 (released April 30, 1993), at para. 21. ("Program Access Order").

[7] Implementation of Sections of the 1992 Cable Act, Rate Regulation, MM Docket 92-266, FCC 93-177 (released May 3, 1993) at para. 489 (quoting 1992 Cable Act Sec. 9(a)).

11 of the Act. Cable operators can be forced to set aside up to 15 percent of their channel capacity for leased access programmers. This enforced loss of channel capacity is a direct response to vertical integration concerns and, therefore, reduces the need for additional strict channel occupancy limits.

- **Rate Regulation** -- The Rate Regulation Order imposes a comprehensive scheme, including a rate freeze, rate rollbacks, cost of service hearings, and regulation of basic rates, tier rates, equipment, installation, additional connections, and customer service changes. Further, cable operators are prohibited from passing through full cost increases from vertically integrated programmers. This prohibition is intended to diminish further any incentives for cable operators to favor integrated program services and, therefore, further reduces any rationale for additional strict channel occupancy limits in this proceeding.

- **Must Carry** -- Under the must carry scheme, cable operators are required to set aside up to one-third of their channel capacity for the carriage of certain commercial broadcast signals, plus additional channels for carriage of non-commercial broadcast signals. The broadcasters that are carried on these channels are unaffiliated with the cable operator. Thus, under these rules alone, nearly one-third of a cable operator's channels are blocked from use by programmers vertically integrated with the operator.

- **PEG Access** -- Pursuant to the 1984 Cable Act, cable operators can be -- and almost always are -- required to set aside channels for public, educational, and governmental programming.[8] There are no specific limits on the number of channels that the cable operator must give up for this purpose. Thus, between leased access, must carry, and PEG access, cable operators can be forced to give up a very substantial portion of their capacity to unaffiliated programming. In effect, the leased access, must carry, and PEG access rules themselves constitute a very significant channel occupancy limit. Seen in this light, the argument that concerns about vertical integration require strict channel occupancy limits is particularly unpersuasive.

The Commission already has adopted extensive regulations intended to enhance competition in the video programming marketplace which, at a minimum, reduce whatever ability cable operators and programmers might otherwise have to use horizontal or vertical ownership to engage in anticompetitive behavior, i.e., the very concerns that underlie the subscriber limit and channel occupancy provisions of the Act.

Clearly, there is a strong interrelationship between the regulations the Commission has already adopted and the ownership regulations required by Section 11 of the Act. In fact, the regulations are complementary and, to a great extent, seek to constrain the same behavior. Therefore, the Commission need not

---

[8] 47 U.S.C. 531.

adopt stringent ownership regulations in this proceeding, particularly since both Congress[9] and the Commission[10] have recognized that horizontal ownership combinations and vertical integration produce significant consumer benefits in the form of increased quality and diversity of programming. Thus, to adopt strict ownership regulations here would be regulatory overkill.

This conclusion is also compelled by the sheer weight of the rules imposed as a result of the 1992 Act. The Commission has adopted extensive regulations under the 1992 Act which govern virtually every phase of a cable operator's business, including its relationships with suppliers, competitors, and customers. Congress specifically gave the Commission discretion to adopt balanced ownership regulations. The Senate Report to the Act, which was adopted by the Conference Committee, notes that "[t]he FCC is given discretion in establishing the reasonable limits on horizontal and vertical integration ... The Committee, therefore, will permit the FCC to establish limits that best serve the public interest."[11] The Act also specifically gives the Commission discretion to avoid imposing "limitations which would

---

[9] See, e.g., 1992 Cable Act, Sec. 11(f)(2)(D); House Report at 41 (vertical relationships promote diversity and make possible the creation of new, innovative, and risky programming); id. at 43 (horizontal concentration in the cable industry has benefitted consumers by allowing efficiencies in administration, distribution, and programming procurement).

[10] See, e.g., Notice at ¶ 34 ("consolidation in the cable industry produced significant benefits and efficiencies to consumers").

[11] S. Rep. No 92, 102d Cong., 1st Sess. 80 (1991).

impair the development of diverse and high quality video programming."[12] TCI urges the Commission to exercise this discretion judiciously and to reject the recommendation of some parties to use the 1992 Act as an excuse to "pile on" unnecessary regulations.

III. THE COMMISSION SHOULD ADOPT THE ATTRIBUTION METHOD PROPOSED BY TCI IN ITS OPENING COMMENTS TO IMPLEMENT LIMITS ON HORIZONTAL OWNERSHIP AND CHANNEL OCCUPANCY

In its initial comments, TCI proposed a simple attribution method for calculating limits on horizontal ownership of cable systems and for defining a "video programmer in which a cable operator has an attributable interest" for purposes of channel occupancy limits:

1. Ownership of 10 percent or less of a cable operator or video programmer would not be attributable at all.
2. Ownership of 50 percent or more of a cable operator or video programmer would be fully attributable, but only to the owner(s) having the 50 percent or greater interest in the operator or programmer.
3. Ownership of more than 10 percent of a <u>program service</u> should be attributable to the owner <u>unless</u> there is a single majority shareholder; if there is a single majority shareholder, that shareholder

---

[12] 1992 Cable Act. Sec. 11(f)(2)(G).

should be the only entity to have an attributable interest.

4. Ownership of more than 10 percent but less than 50 percent of a <u>cable operator</u> of which there was <u>not</u> a single holder of 50 percent or more would be attributable by calculating the operator's total number of homes passed and attributing to each owner a share of that total equal to the owner's percentage ownership interest in the operator. (Thus, for example, the owner of a 20 percent interest in a cable system that passes 10,000 homes would be attributed 2,000 homes.)

TCI's suggested approach is similar in concept and principle to those advanced by Discovery Communications, Inc., (Comments at 19-20), Liberty Media Corporation (Comments at 36-37), and Time Warner Entertainment Company, Ltd. (Comments at 37-40). However, TCI's proposal embodies clear numerical limits rather than inviting *ad hoc* disputes over the presence or absence of "control" in particular cases. TCI's proposal is therefore unreasonably stringent and burdensome attribution schemes. For example, the Motion Picture Association of America argues that the complex broadcast attribution rules in the notes to 47 C.F.R. Section 73.3555 should be applied in the context of cable system subscriber limits and channel occupancy, advancing as its only reason the erroneous assertion that the Senate Report "instructs" the Commission to do so. MPAA Comments at 6. Of course, the relevant legislative history itself makes clear that the Commission is free to adopt either the broadcast rules or other attribution rules (such as those proposed by TCI) that the Commission reasonably determines to be appropriate.[13]

The Association of Independent Television Stations (INTV) argues (Comments at 15-16) that rules even more stringent than those applicable to INTV's broadcaster members should be adopted in this proceeding. Apparently searching for the most stringent precedent available, INTV advocates a five percent limit based on the original version of the cable/telephone cross-ownership restrictions. However, those restrictions, intended to give effect to a policy judgment that telephone companies should not own any appreciable interest in cable systems in their service areas,[14] are wholly irrelevant to the statutory purposes and ability to evade price restraints), but rather with issues of control.

No commenter advanced a better or more viable approach to attribution than that put forth by TCI. Thus, the principal question remaining is whether precedent or policy should lead the Commission to adopt some attribution scheme other than that advanced by TCI.

B. The Attribution Method Adopted in the Program Access Rulemaking Is Inappropriate for Purposes of Horizontal Ownership and Channel Occupancy Rules

In its recently released Program Access Order, the Commission adopted a strict 5 percent attribution rule for identifying vertically integrated programming.[15] The Commission further declined to apply the "single majority shareholder" principle of its broadcast rules and made certain limited partnership interests attributable regardless of insulation.[16] The Commission based this result on a policy determination that the attribution rule selected should depend on the specific policy being implemented, "e.g., whether control, influence or some other aspect of the relationship is involved," and should also reflect "an evaluation of the costs and risks associated with various levels of ownership or influence."[17]

---

15 Program Access Order at ¶¶ 31-33.

16 Id.

17 Id. at ¶ 31.

TCI expects that the same parties that have already argued for inappropriately stringent attribution limits in this proceeding will seize upon the 5 percent figure adopted in the Program Access rulemaking, take it out of context, and argue for its application in this proceeding. However, the Commission must focus clearly on the context in which the 5 percent limit in Program Access was adopted and recognize that, whatever the merits of that rule in meeting the particular objectives identified in the Program Access rulemaking, the objectives to be met in <u>this</u> proceeding are quite different and would best be met by adoption of the approach proposed by TCI.

The Commission made clear that its concern in the Program Access proceeding was with "influence," not control.[18]

In the Program Access proceeding, the Commission noted specifically the benefits of a clear rule rather than one based on <u>ad hoc</u> assessments of individual companies' behavior. TCI submits that a comparable degree of certainty is desirable in implementing the rules which are adopted in this proceeding. For this reason, TCI has proposed straightforward, objective, numerical limits that reflect, in practical terms, all of the control-related concerns underlying the Cable Act provisions being implemented here.

IV. RESPONSE TO COMMENTS OF OTHER PARTIES ON SUBSCRIBER AND CHANNEL OCCUPANCY LIMITS

1) <u>Motion Picture Association of America ("MPAA")</u> -- In its comments, MPAA proposes a subscriber limit of 25 percent and a channel occupancy limit of 20 percent. MPAA acknowledges that "[t]he Commission's role is to balance" the benefits and potential harms of vertical and horizontal ownership. Yet, it makes no attempt to engage in such balancing. MPAA does not address the well- established fact that vertical and horizontal ownership arrangements produce efficiencies that increase program diversity and lead to technology advancements. Nor does it explain how its proposals would do anything other than diminish these factors which clearly enhance consumer welfare.

In its initial comments, TCI submitted a paper entitled "An Economic Analysis of the FCC's Proposed Cable Ownership Restrictions," prepared by Stanley M. Besen, Steven R. Brenner, and John R. Woodbury (the "Besen Paper"). The Besen Paper demonstrates that limits on horizontal ownership will have the effect of diminishing the quality and diversity of programming:

> Economies of scale also exist in administration and planning for new technologies and services. Many of the costs of these activities are independent of the number of subscribers being served. Because smaller MSOs will have higher costs per subscriber, they are likely to [illegible]

antidiscrimination rules and leased access rules; and 3) the Commission will adopt reasonable attribution criteria. But none of these factors provides any rationale for a particular subscriber limit. MPAA simply recites the obvious fact that there are other sections of the Act that address the same questions as those raised in Section 11. These sections do not, however, provide any quantitative or qualitative support for MPAA's proposed 25 percent limit. If anything, these other provisions, as the Commission has recognized, provide support for much higher limits than MPAA proposes.[20]

MPAA provides no other basis for its proposed subscriber

MPAA offers no substantive rationale for its proposal. MPAA simply asserts that its proposal is "simple and straightforward."[21] Administrative ease is certainly a laudable goal, but it is not a sufficient basis for the Commission to adopt rules under Section 11. Nor is MPAA's conclusory statement that it "believe[s] an occupancy limit of this level [20 percent] would avoid chilling new programming investments by cable operators," sufficient.[22] What is the basis for that belief? What evidence does MPAA cite to support such a limit? What rationale does MPAA offer to justify its conclusions? The answer is that MPAA states no basis, cites no evidence, and offers no rationale.

As a result, it would be arbitrary and capricious for the Commission to adopt MPAA's proposals. This is particularly true because significant quantitative and qualitative evidence has been submitted in the record in this proceeding that demonstrates that MPAA's proposals are unjustified and would harm consumers. More importantly, adoption of MPAA's proposals would be irresponsible. The Commission should not resolve the serious issues raised in Section 11 based on a proposal for which the proponent has offered literally no analytical or empirical support.

2) <u>The Association of Independent Television Stations, Inc. ("INTV")</u> -- INTV's comments suffer from many of

INTV also proposes strict local and regional ownership limits. Its argument for such limits rests on the assertion that cable operators are "the conduit for all local advertising" and that other local media "find themselves at considerable disadvantage" in competing for local advertising.[27] This assertion is preposterous. Even a cursory analysis of the facts disproves INTV's position.

Far from being at a "considerable disadvantage," local television stations dominate the local advertising market. In 1991 there was an eighteen-fold difference between the amount spent for local television advertising and local cable advertising. Total expenditures by advertisers for local cable advertising were $420 million, while $7.57 billion was spent for local television advertising.[28] Between 1984 and 1991, the amount spent for local cable advertising grew by $340 million, while the amount spent for local television advertising grew by $2.48 billion. Even if the cable industry were able to sustain an annual growth rate in local cable advertising of 20 percent, it would be a decade before those revenues were half the amount of the 1991 local television advertising revenue.

It is disingenuous to claim that a threat to the local advertising revenues of local broadcasters justifies the

---

[27] INTV at 7-8.

[28] 1993 Television & Cable Factbook at I-16. Unless otherwise noted, all of the advertising figures discussed herein are set forth (or derived from) the 1993 Television & Cable Factbook at I-16.

imposition of cable ownership restraints at the local level. The facts definitively prove the opposite: Local television stations have an overwhelming share of local advertising revenue.

TCI opposes the imposition of structural limits based on the strength of entities in the local advertising market. However, if the Commission is inclined to impose limits on that basis, such limits clearly should be imposed only on the entities that have the ownership power in that market: INTV members and other local broadcasters.

INTV also proposes channel occupancy and program production limits that would hold cable operators at their current levels, with no future growth permitted. These proposals would have the effect of prohibiting companies that have been important contributors to the development of new program services from continuing to make investments to further increase the quality and diversity of programming. INTV fails to explain how such a proposal is consistent with the public interest.

More importantly, the Commission should recognize that there is a clear theme in all of INTV's proposals. INTV asks for absurdly low limits on national horizontal ownership, far-reaching new limits on local and regional ownership, a freeze on vertical ownership, and a ban on expanded program investment by cable operators. The purpose and effect of each of these proposals is to reduce competition. In the aggregate, INTV's proposal would eliminate any risk that the cable industry could provide a further competitive spur to INTV's members. INTV seeks no less than a sweeping, government-granted immunity from competition.

The Commission should reject INTV's proposals. Congress had many purposes in passing the Act, but surely eliminating investment, growth, and competition was not among them.

3) David Waterman -- In a letter to the Commission submitting two papers, Waterman states that "[m]y economic analysis ... strongly suggests that an MSO having less than the Commission's suggested 25-30 percent national share limit may exert excessive market power over networks -- particularly new entrants -- in the current market environment."[29] However, Waterman's analysis supports neither a general conclusion that the current market environment has caused harm to consumers, nor the specific conclusion that a 25-30 percent share limit would be appropriate. Waterman's letter simply asserts results that do not appear in his accompanying papers.

Waterman bases his conclusion on a model in which "coalitions" of local cable systems bargain with "coalitions" of program services over the distribution of the revenues generated by those services.[30] Two assumptions in the model appear to be

---

[29] Letter from David Waterman to Office of the Secretary, Federal Communications Commission, February 8, 1993, at 2.

[30] Essentially the same model appears in both D. Waterman, "Local Monopsony and 'Free Riders' in Information Industries," March, 1992, and "Multiple Cable Television System Operators and Monopsony Power," Presented at the Airlie House on Telecommunications Policy Research Conference, October 1-3, 1990. Waterman's model refers to cable systems as "retailers" and cable program services as "upstream firms."